

# SDG & Tax Incentives



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**INFF**

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The Kyrgyz Republic is introducing an article into the new Tax Code on principles of tax incentives effectiveness, which establishes a provision of tax incentives for promoting sustainable development of the country.



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One of the key instruments that the Kyrgyz Government is using to engage and attract private investment is tax incentives. These are significant in scale, estimated to cost around 5% of GDP in foregone revenue, and in 2020 it reached 32,3 billion som (see table 1). Yet the systems to monitor their use and impact, manage their effectiveness, and report on their costs and benefits, were underdeveloped.

The Kyrgyz Republic provides tax incentives both to support the development of a certain sector of the economy and certain categories of taxpayers. At the same time, some tax incentives are not well-targeted as some tax incentives have the same effect on all taxpayers: in particular, standard income tax deductions or deductible expenses for income tax, and zero rates of VAT for export supplies. The total amount of tax incentives, exemptions, and preferences granted under the Tax Code is estimated at about 30.0 billion som, this amount does not include the standard benefits, which have the same effect on all taxpayers. Despite the significant amount of tax incentives, exemptions and preferences granted, initiatives are periodically raised to provide additional benefits for certain taxpayers or sectors of the economy without well-grounded justification, based on certain methodology. One of the reasons of this situation is associated with the absence of a system to regularly assess the efficiency of provided tax incentives. While the Government has a methodology for assessing the efficiency of tax incentives, it was not operational, as the previous Tax Code had no such requirement.





To address this challenge, INFF has provided support to the Ministry of Economy and Commerce (MoEC) in drafting and introducing an article into the new Tax Code on principles of tax incentives effectiveness, which establishes a provision of tax incentives for promoting the sustainable development of the country. In particular, it sets a framework for providing tax incentives only for the following purposes<sup>1</sup>:

- promoting **sustainable development** of the country;
- attracting investment and financing to priority sectors of the economy for **sustainable development**;
- achieving the priorities of the **National Development Strategy (NDS)**;

This article can serve a gatekeeper function in introducing new tax incentives and assessing the current incentives, as the authorities would be guided by the above-mentioned principles, stipulated in Article 14 of the Tax Code.

As the country's priorities may change over the years, the new Tax Code set a requirement to annually conduct the assessment of tax incentives to monitor their relevance. This approach will enable the authorities to regularly assess the efficiency of each tax incentive and take respective and timely decisions on their continuation or cancellation. This in turn will enable the authorities to generate more revenues for financing the NDS priorities and introduce new tax incentives that could attract private investment to the sustainable development priorities of the country.

In addition, the INFF supported an analysis of provided tax incentives against the SDGs<sup>2</sup> for the last five years. According to the analysis, 40% of the incentives are focused on SDG 8, 33% on SDG 1, which shows the government's efforts to ensure economic growth and end poverty through providing tax incentives in these directions. SDG 3 and 9 receive about 9% and 8% incentives respectively. The SDG 3 incentives were considerably increased in 2020 due to the COVID-19 outbreak. Other SDGs received less than 11% incentives during the considered period. Interestingly the SDG 4 related incentives were about 0.2%, which can be implied that there is room to utilize the tax incentives instrument to attract private investment into the sector. This will enable the country to improve the quality of education, which in turn will lead to a more qualified nation and economic growth.

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<sup>1</sup> Article 14 of the Tax Code. Principle of Tax Incentives Effectiveness

1. Tax incentives shall be aimed at achieving the objectives stipulated in this Article.
2. Tax incentives shall be granted for the below purposes of:
  - 1) promoting sustainable development of the economy of the Kyrgyz Republic;
  - 2) attracting investment and financing to priority sectors of the economy for sustainable development;
  - 3) achieving the main priorities of the National Development Strategy of the country;
  - 4) social support of the population;
  - 5) promotion of socially useful, including charitable, activities.

An individual entrepreneur and an organization applying a tax incentive shall be obliged to provide information to assess the effectiveness of the tax incentive in the manner prescribed by this Code.

<sup>2</sup> In assigning the tax incentives against SDGs three approached were utilized:

1. Tax incentives are linked to the relevant SDGs in accordance with the objective of tax incentives, reflected in the justification statements to the draft Laws of the Kyrgyz Republic.
2. Tax benefits are linked to SDGs under various programs and strategies for development of industries, spheres of activity and directions, as well as under sectoral legal acts.
3. An expert approach.

**Table 1. Tax incentives assigned to SDGs, million som.**

Indicators / SDGs	2016	2017	2018	2019	2020	Total	In %
GDP	476 331,2	530 475,7	569 385,6	619 102,7	601 820,3		
Total amount of incentives	22 628,1	24 635,3	25 222,2	29 191,6	32 256,6	<b>133933,9</b>	
<b>Share to GDP, %</b>	<b>4,8</b>	<b>4,6</b>	<b>4,4</b>	<b>4,7</b>	<b>5,4</b>		
SDG 1. No poverty	8942,7	8167,1	7961,3	8806,7	9858,0	<b>43735,8</b>	33
SDG 2. Zero hunger	1022,6	1023,7	840,7	875,6	516,9	<b>4279,6</b>	3
SDG 3. Good health and well-being	1802,5	2082,2	2092,1	2339,3	3222,7	<b>11538,7</b>	9
SDG 4. Quality Education	51,0	44,5	55,1	70,6	55,8	<b>276,9</b>	0
SDG 6. Clean water and sanitation	254,3	257,2	260,2	320,4	351,1	<b>1443,2</b>	1
SDG 7. Affordable and clean energy	745,4	818,8	826,8	917,3	1047,4	<b>4355,8</b>	3
SDG 8. Decent work and economic growth	7072,2	9523,8	9199,5	12358,3	14956,6	<b>53110,4</b>	40
SDG 9. Industry, innovation and infrastructure	1959,8	1781,3	3249,5	2685,0	1533,6	<b>11209,1</b>	8
SDG 10. Reduced inequality	226,0	218,6	213,9	226,1	229,0	<b>1113,5</b>	1
SDG 11. Sustainable cities and communities	123,7	213,7	102,7	201,3	130,2	<b>771,7</b>	1
SDG 15. Life on land	153,0	153,1	153,3	157,9	158,8	<b>776,1</b>	1
SDG 16. Peace, justice and strong institutions	3,3	62,0	13,9	20,4	13,4	<b>112,9</b>	0
Incentives difficult to assign to SDGs <sup>3</sup>	271,6	289,2	253,3	212,6	183,1	<b>1209,9</b>	1%
<b>Total</b>	<b>22628,1</b>	<b>24635,3</b>	<b>25222,2</b>	<b>29191,6</b>	<b>32256,6</b>	<b>133933,9</b>	

**\*Source: MoEC**



## NEXT STEPS

INFF will support MoEC in updating the draft methodology on the assessment of tax incentives efficiency. The methodology will be strengthened by incorporating criteria on sustainable development, aligning it with the NDS/SDG priorities, and improving the tax forms to collect information for the assessment.

<sup>3</sup> These incentives are related to exemption on corporate tax for State service on special security services of Ministry of Internal Affairs, VAT on imports for diplomatic missions, import VAT on military related products, property tax exemption for diplomatic institutions, exemptions on land tax for territories of cemetery, degraded agricultural land, cattle passes and cattle staging areas.